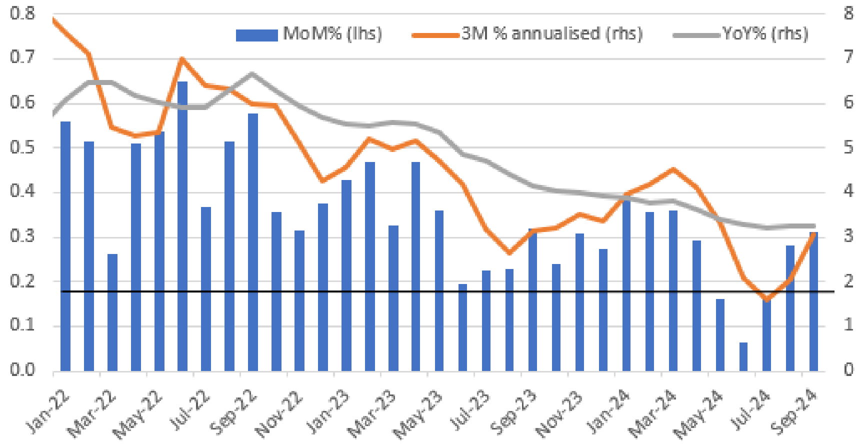
Mixed US data keeps the Fed guessing

The battle between the US jobs numbers and the inflation data with regards to the outlook for Fed policy remains unresolved. As such policymakers will need to tread carefully, but our base case remains 25bp rate cuts in November and December

Core inflation still tracking high

The September US consumer price inflation data is hotter than predicted by a tenth of a percentage point for both headline and core (0.2% and 0.3% month-on-month respectively). This is the second consecutive 0.3% MoM print for core inflation, which as the chart below shows is not a great look. We need to average 0.17% MoM over 12 months to deliver 2% year-on-year inflation and the US economy is tracking higher than that right now – the black line marks 0.17%.

US core CPI metrics



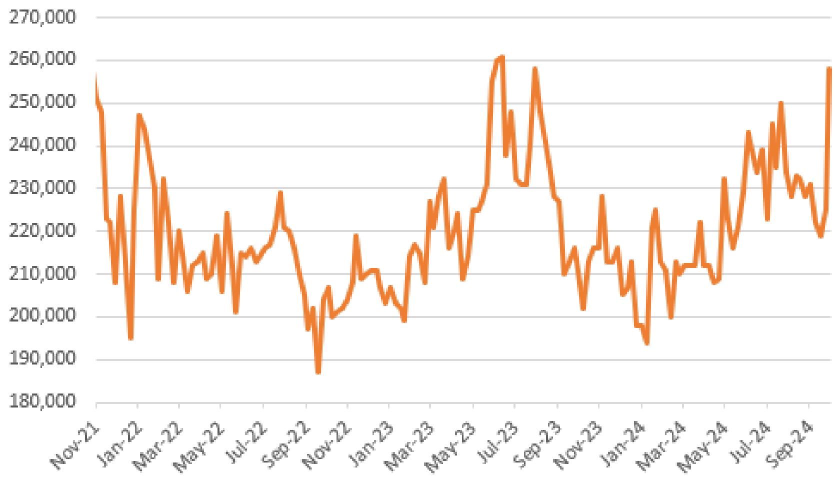
Source: Macrobond, ING

The details show that energy prices did fall as expected, but food was much firmer, posting a 0.4% MoM gain. With regards to core (ex food & energy) inflation the breakdown shows the very hot sectors were apparel (+1.1%), airline fares (+3.2%), medical care (+0.4%) with used cars up 0.3%. However, most other components looked reasonably good with housing posting a relatively benign 0.2% MoM outcome, recreation falling 0.4% MoM, education and communication coming in flat. In terms of what it may mean for the Fed's favoured inflation measure, the core personal consumer expenditure deflator, there is still a decent chance of a 0.2% MoM outcome if tomorrow's PPI report is better behaved. Medical care and airline fares come from that methodology in the core PCE deflator.

Weather impact adds to labour market volatility

Meanwhile, the labour market data is weaker than anticipated with initial jobless claims spiking to 258k from 225k (consensus 230k). Continuing claims also moved sharply higher to 1861k from 1819k (consensus 1830k). It may well be reflecting distortions to the terrible weather several states have encountered and this could be a theme that generates significant volatility in this series over the next few weeks. Nonetheless, it reinforces the message that conflicting messages in the data – coming after last week's strong jobs report – makes policymaking very challenging and justifies moving with caution.

US initial jobless claims



Source: Macrobond, ING

Fed set to continue gradually cutting rates by 25bp

In yesterday's minutes to the September FOMC meeting the Fed sounded fairly relaxed about the inflation story – "participants noted that further cooling [in the jobs market] did not appear to be needed to help bring inflation back to 2 percent." However, "a couple of participants specifically noted upside inflation risks associated with geopolitical developments" while "some participants cited risks" that improvements in inflation could be "stalled by a larger-than-anticipated easing in financial conditions, stronger-than-expected consumption growth, or continued strong increases in housing services prices". This suggests that tentative rate cuts are the most likely path forward for the Federal Reserve.

In a recent speech Fed Chair Jerome Powell suggested their baseline is 25bp increments from now on unless something changes and we think that is the path they will indeed take. We characterise the Fed's policy loosening as a risk mitigation move. Monetary policy has been restrictive for some time and now that inflation is looking as though it is on the path to 2% it makes sense to lower borrowing costs to give the economy a little more breathing space.

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